



REPORT ON THE MAIN BUDGETARY LINES OF THE PUBLIC ADMINISTRATIONS 2019

REPORT 45/18



The Independent Authority for Fiscal Responsibility (AIReF, for its acronym in Spanish) was created with the mission of ensuring strict compliance with the principles of budgetary stability and financial sustainability set out in article 135 of the Spanish Constitution.

AIReF Contact:

C/José Abascal, 2, 2º planta. 28003 Madrid, Tel. +34 910 100 599

Email: Info@airef.es.

Website: www.airef.es

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EXECUTIVE SUMMARY

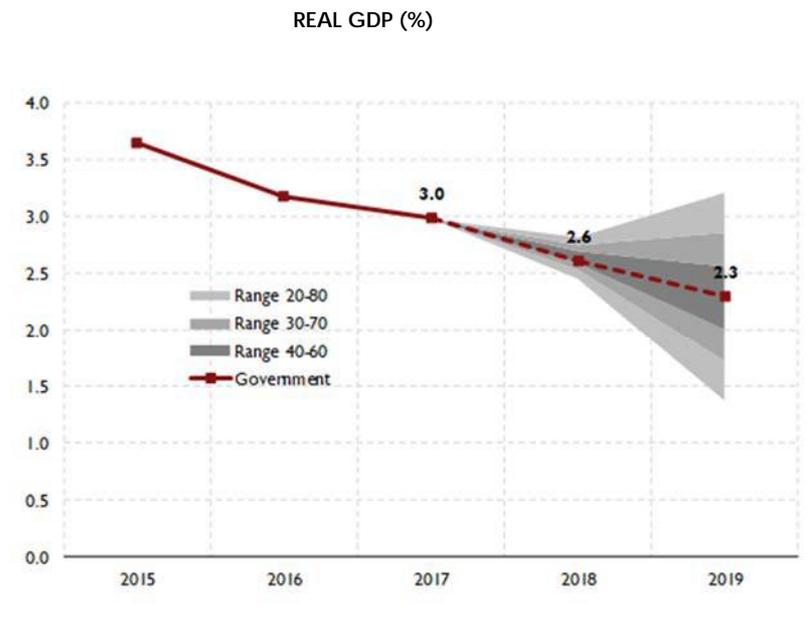
This report analyses the macroeconomic and fiscal scenario contained in the 2019 Budgetary Plan sent to the European Commission on 15 October. Current legislation provides that the Independent Authority for Fiscal Responsibility (AIReF) must prepare a report before 15 October on the draft budget and main budgetary lines of the Public Administrations. If the General State Budget is not presented, the Budgetary Plan is configured as the major milestone of Spain's fiscal strategy for 2019. Therefore, AIReF prepares a report on the macroeconomic forecasts underlying the 2019 Budgetary Plan as well as its budgetary scenario, with a special assessment of the impact stemming from the planned revenue and expenditure measures. This analysis results in a series of recommendations and suggestions for best practice.

AIReF endorses the macroeconomic forecasts and considers the budgetary scenario presented by the Government to be feasible. AIReF considers the Government's macroeconomic scenario to be prudent overall, taking into account the exogenous assumptions and defined policies. On the other hand, AIReF considers the budgetary scenario of the Budgetary Plan to be feasible, although it believes there is no scope to assume deviations in the estimated impact of the measures.

The starting point for the analysis was the 'no policy change' scenario published in July, on the study on the 2018-2019 macroeconomic and budgetary scenario commissioned by the Government. On 10 July AIReF published a study on the macroeconomic and budgetary scenario for 2018 and 2019 under the assumption of no policy change. This study forecasted a robust GDP growth of 2.8% for 2018 and 2.6% for

2019, although more moderate than in previous years, with domestic demand as the main driver and supported by a slight positive contribution from the external sector. On the fiscal side AIReF estimated a baseline deficit scenario for the General Government (GG) of 2.7% and 2.2% GDP in 2018 and 2019, respectively.

Since the publication of this inertial scenario in July there have been changes in the assumptions and new information that have led to a downward revision in growth for 2018 and 2019. National Accounts have published all the information concerning the second quarter of the year and. All the Quarterly National Accounts from the first quarter of 2015 until the first quarter of 2018 have been revised to make them compatible with the Annual National Accounts. In addition, changes in the exogenous assumptions have focused on two facts: first, the increase in the price of oil which has an impact on the price of energy imports and, secondly, the downturn of the global economy, a result of trade disputes, which affects external demand.



The budgetary execution data and information available from the main budgetary lines of the Territorial Administrations have raised the deficit forecasts by 0.1% in 2018 and 2019. The revision of the 2017 year-end data, the 2018 execution data and the main budgetary lines of the Regional Administrations have entailed an upward revision of the revenue and expenditure estimates which has resulted in a new estimate of 2.8% deficit in 2018 and 2.3% in 2019.

- **Assessment of the 2019 macroeconomic scenario**

The basic assumptions underlying the macroeconomic scenario accompanying the 2019 Draft Budgetary Plan are considered feasible and the composition of growth is considered plausible. With respect to the last official update, the assumptions made by the Government relating to the external environment have been revised downward and are in line with major international organisations and market expectations. The expected path for 2019 continues to be based on domestic demand as the main source of growth, based on the positive evolution of investment, particularly in the construction branch. The evolution of private consumption is in line with AIReF's forecasts, following a revision of the latest quarterly data published by the National Statistics Institute at the end of September. In turn, the Government's public consumption forecast has been revised upward, in line with the latest available information and forecasts from AIReF's models, reflecting some of the measures contained in the Budgetary Plan. Finally, the Government has made a downward revision of the foreign sector's contribution, leaving its contribution to growth at neutral. This update is in line with AIReF's internal forecasts and uses the latest available information on the more contained evolution of exports.

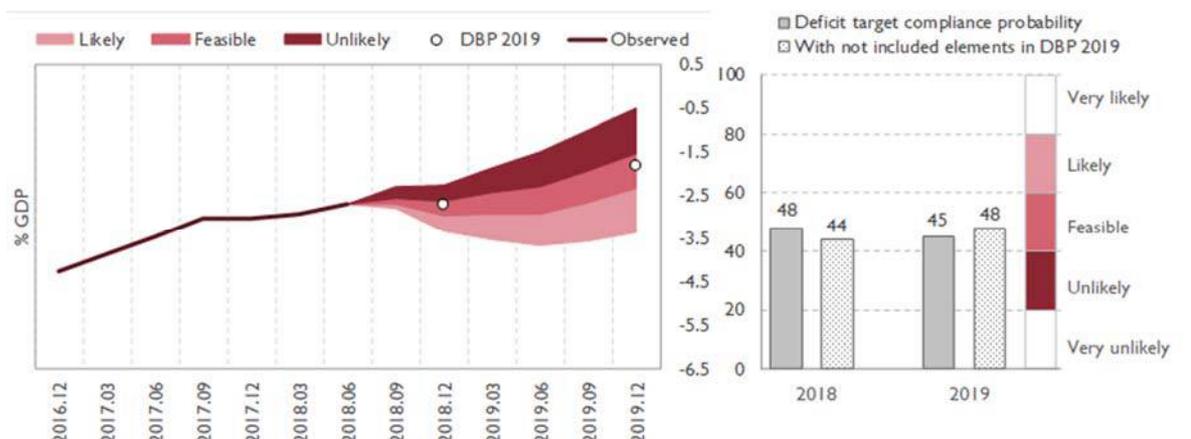
The macroeconomic impact of the measures advanced by the Government is considered feasible. The macroeconomic impact of the measures analysed is moderate - neutral in real terms and positive in nominal terms - although there are downside risks beyond 2019. This assessment conducted by AIReF based on its internal models is in line with the impact included by the Government in the Budgetary Plan. AIReF appreciates the access related to the inertial scenario provided by the Government, which allowed the macroeconomic impact assessment of the measures and their main transmission channels.

- **Assessment of the 2019 budgetary scenario**

For 2019, the revision of revenue and expenditure, including the movement of the expected impact of a judgement on the annulment of the concession contract for the Ter-Llobregat (ATL) water supply to 2018, place the deficit forecasted by AIReF under the assumption of no policy change at 2.3% GDP. With respect to the July forecast, which included a deficit of 2.2%, expenditure has been revised upward by 0.4% GDP, while the baseline revenue scenario has increased by over 0.2%. In this revision the expected impact of a judgement on the annulment of the concession contract for the Ter-Llobregat water supply has moved to 2018. With the information available to date, it is estimated that the most likely scenario is that the transfer of assets resulting from this judgement will occur before the end of 2018.

According to AIReF's estimates, the new measures included in the Budgetary Plan would correct the deficit by between 0.2% and 0.4% GDP. AIReF has estimated a potential impact of the revenue measures of between 0.4% and 0.6% GDP, while the new expenditure measures account for slightly more than 0.2%. In general, these measures will be included in the draft General State Budget, although most revenue measures require the implementation of legal changes through their own laws as is the case with the creation of new taxes.

2018-2019 NET LENDING/BORROWING PATH. GENERAL GOVERNMENT IN % GDP.



Regarding revenue measures, AIReF has estimated an increased potential collection of between 0.4% and 0.6% GDP, appreciating the greater uncertainties in the new taxes. The proposed measures consist in the modification of existing taxes as is the case of Corporate Income Tax, Social Security Contributions, the Tax on Hydrocarbons and Personal Income Tax, as well as the creation of new taxes such as the Tax on certain Digital Services and the Tax on Financial Transactions. Most of these measures affect the Central Administration and Social Security Funds.

REVENUE MEASURES FOR 2019: BUDGETARY PLAN AND AIReF ASSESSMENT (millions of euros)

Revenue measures	Budgetary Plan 2019	AIReF estimates 2019
Corporate income tax: Limitation on exemptions and deductions for double taxation and minimum rate on taxable base	1,776	(1650 ; 1900)
Corporate Income Tax: Discounted rate for SMEs	-260	(-242 ; -278)
Tax on Financial Transactions	850	(420 ; 850)
Tax on certain Digital Services	1,200	(546 ; 968)
Increase of personal income tax rates on higher income	328	(245 ; 255)
Green taxation (Hydrocarbons Tax)	670	(649 ; 693)
VAT: Reduced rates for veterinary services	-35	-35
VAT: Gender taxation and inequality	-18	-18
Fight against fraud: Limitation of cash payments	218	(100 ; 200)
Fight against fraud: Strengthen list of defaulters	110	(50 ; 100)
Fight against fraud: International best practices for preventing and combating fraud	500	(200 ; 270)
Social contributions due to the rise in the SMI	1,500	(1,500 ; 1,700)
Wealth Tax	339	(0 ; 8)
Total measures Budgetary Plan	7,178	(5,065 ; 6,613)
Measure not developed in the Budgetary Plan		
Increase maximum contribution bases	-	(1,000 ; 1,100)
TOTAL MEASURES	7,178	(6,065 ; 7,713)

AIReF estimates an impact of the new expenditure measures contained in the Budgetary Plan of 0.2% GDP, departing from the Government's projections, mainly due to the estimated impact in the Regions of the abolition of the pharmaceutical co-payment to pensioners. In the GG the measures with a greater quantitative impact affect expenditure on pensions and other social benefits such as dependency, paternity leave or pharmaceutical co-payment to pensioners, the abolition of which is not quantified in the Budgetary Plan.

EXPENDITURE MEASURES FOR 2019: BUDGETARY PLAN AND AIReF ASSESSMENT (millions of euros)

Expenditure measures	Budgetary Plan 2019*	AIReF estimate 2019
Revaluation of pensions to the CPI and increase of minimum and non-contributory pensions to 3%	736	843
<i>Pension revaluation to CPI</i>		518
<i>Increase of minimum and non-contributory pensions</i>		325
Measures quantified jointly in the Budgetary Plan	1,318	1,318
Improve minimum and agreed level of dependency.		515
SS caregiver contributions		0
Increase in the minimum wage to 900€ per month		0
Recover subsidy for those older than 52 years		323
Paternity leave of 5 to 8 weeks		300
Minimum income		180
Measures listed in the Budgetary Plan and quantified in the additional information	425	725
Increased funding for scholarships	150	150
Aid for school materials	50	50
Meal aid	25	25
Increase in Science and R+D+i line items	150	150
Support for the production and promotion of film productions in different languages	20	20
Gender Violence Pact	20	20
Depopulation offices	10	10
Elimination of co-payment		300
TOTAL MEASURES	2,479	2,886

(*) The quantification of the measures of the Budgetary Plan was provided in the additional information provided by the MINHAC. The measures that appear quantified together in the Budgetary Plan amount to 1,364 million, but this amount is reduced to 1,318 million according to the additional information provided.

AIReF's recommendations focus on strengthening the monitoring of the risk areas identified and developing a medium-term fiscal strategy that allows a permanent deficit reduction. AIReF identifies three areas; newly created taxes, fiscal impact of the expected rise in the Minimum Wage and the growing trend of the expenditure of the Regional Administrations, where the quantitative relevance and high uncertainty point towards a strengthening of the monitoring beyond the one generally stipulated by the Organic Law on Budgetary Stability and Financial Sustainability.

Similarly, AIReF continues to emphasise the need to develop a medium-term fiscal strategy that includes measures oriented towards a permanent deficit reduction and recommends that this be reflected in the 2019-2022 Stability Programme Update which will take place next April.